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Approved For Release 2005/08/22 : CIA-RDP85T00875R001900020107-8

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8-6148

CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

CIA/OER/S-06148-74

1 May 1974

MEMORANDUM FOR: Mr. Richard Erb
Council on International Economic Policy
Old Executive Office Building

SUBJECT : Foreign Economic Prospects in 1974

The attached table and annex were prepared in response to your request on 29 April for our assessment of foreign economic prospects in 1974. Our estimates, and the latest OECD estimates, of the likely rate of growth in real GNP and the GNP price deflator, and estimates of the current account balance, for Canada, Japan, France, West Germany, Italy, and the United Kingdom are presented in the table. More detailed growth, price, and trade forecasts by country and accompanying notes are in the annex.



Attachment: a/s

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OECD and CIA Projections

	<u>Total Year 1974</u>		<u>1st Half 1974</u>		<u>2nd Half 1974</u>	
	<u>Estimated</u>		<u>Estimated</u>		<u>Estimated</u>	
	<u>OECD^{1/}</u>	<u>CIA^{2/}</u>	<u>OECD^{1/}</u>	<u>CIA^{2/}</u>	<u>OECD^{1/}</u>	<u>CIA^{2/}</u>
<u>REAL GNP GROWTH (percent change)</u>						
Canada	4.3	4.5	4.0	5.0	5.0	4.0
Japan	1.8	4.0	-5	1.0	5.5	6.0
France	4.3	3.8	4.0	3.8	3.3	4.6
Germany	.8	2.5	1.0	2.6	2.3	4.6
Italy	5.0	3.0	3.0	0.6	4.0	1.8
United Kingdom	-2.5	-2.0	-11.0	-8.0	12.5	9.0
<u>GNP DEFLATOR (percent change)</u>						
Canada	8.0	8.2	8.5	8.5	7.3	7.8
Japan	16.5	25.0	17.0	32.0	12.8	10.0
France	12.0	10.0	13.8	11.0	11.5	9.0
Germany	7.0	7.0	7.0	9.8	6.0	8.4
Italy	11.0	15.0	10.0	18.0	13.5	11.0
United Kingdom	10.5	11.0	10.0	14.0	14.0	9.0
<u>CURRENT ACCOUNT BALANCE (billion US \$)</u>						
Canada	0	-1.2	0	-.5	0	-.7
Japan	-7.5	-7.9	-4.0	-5.9	-3.5	-2.0
France	-3.5	-4.3	-2.0	-2.0	-1.5	-2.3
Germany	-1.0	2.5	0	1.5	-1.0	1.0
Italy	-5.5	-	-3.0	-	-2.5	-
United Kingdom	-8.0	-9.0	-4.0	-5.0	-3.5	-4.0

^{1/} As reported in CIEP Paper 4 February 1974^{2/} See country annexCIA/OER
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ANNEX

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Canada

1974 Prospects

Canadian real GNP will probably increase about 4.5% this year, the best performance of any developed country. The economy should grow around 5% in the first half, spurred by strong investment demand in manufacturing and the resource industries. Growth should slow, however, to about 4% in the second half because of sluggish export demand. OECD and official growth estimates are similar to our own.

We expect the GNP price deflator to increase about 8.2% this year, or at about the same rate as predicted by the OECD. The slowing of the rate of price increase at the end of 1973 proved to be temporary and the rate of inflation accelerated in the first quarter. Inflationary pressures are likely to remain strong during the remainder of the year because of increasing oil prices, remaining supply and capacity constraints, and rising wages. Labor unions are expected to secure wage hikes at 10-11% in the current round of negotiations.

The Canadian current account is expected to show a \$1.2 billion deficit this year, \$1.2 billion more than expected by the OECD. The trade surplus should decline from \$2.1 billion in 1973 to \$1.4 billion. This is primarily due to the economic slowdown abroad and its depressing effects on exports, and the rapid growth of Canadian imports.

Government Policies

Canada is continuing its moderately expansionary monetary and fiscal policies, although there are indications that monetary policy will tighten somewhat. The monetary authorities are very concerned about last year's rapid money supply growth and continuing strong inflationary pressures. Trudeau's minority government, however, is not expected to take strong action to combat inflation. Ottawa has indicated that the new federal budget is intended to support demand and if serious unemployment problems develop later in the year, it probably will request supplementary outlays from Parliament.

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CANADA

	<u>1973</u>	<u>1st Qtr 1974 Preliminary</u>	<u>1st Half 1974 Estimated</u>	<u>2nd Half 1974 Estimated</u>	<u>1974 Estimated</u>
	<u>Percentage Change at Annual Rate^{1/}</u>				
GNP Constant Prices	7.1	--	5.0	4.0	4.5
GNP Price Deflator	7.1	--	8.5	7.8	8.2
Consumer Prices	9.2	11.2			
Wholesale Prices	25.7	21.6			
Money Supply (m1)	14.4	12.4			
Money Supply ^{2/}	13.4	28.4			
	<u>Billion US \$</u>				
Trade Balance	2.1	.1	.9	.6	1.4
Current Account Balance	-.3	--	-.5	-.7	-1.2
Basic Balance	.3	--	0.0	-.2	-.2
Official Reserves ^{3/}	5.8	6.1			

^{1/} Change from previous period^{2/} M1 plus all privately held deposits^{3/} End of period

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Japan

1974 Prospects

We expect Japanese real GNP to grow 3-5% this year, compared with a long-run average growth rate of more than 10%. The economic slowdown is the sharpest since the 1950s. GNP should grow only about 1% (at an annual rate) during the first half of the year. A modest recovery will boost the economy's growth to around 6% in the second half, assuming government monetary and fiscal policies become somewhat less restrictive.

This projection is somewhat optimistic, although most forecasters predict some recovery in the second half. The OECD expects real GNP to decline about .5% in the first half of the year and then to grow around 5.5% in the second half. The respected Japanese Economic Research Center predicts that real GNP growth for the calendar year will average only 2.8%, while the official growth forecast for the fiscal year ending 31 March 1975 is only 2.5%.

The GNP price deflator is expected to increase about 25% this year, substantially more than predicted by the OECD. The rate of price increase during the first quarter apparently exceeded 40%, but tighter monetary and fiscal policies and patchwork price controls apparently are having a dampening effect. After showing big jumps in January and February, the wholesale and consumer price indices increased less than 1% in March. Nevertheless, major price hikes for oil implemented on 18 March and a round of wage settlements approaching 30% will push prices up in coming months, although not as fast as they rose in the first quarter.

We expect the Japanese current account to show a nearly \$8 billion deficit in 1974, about the same as expected by the OECD. The trade balance is expected to shift from a \$3.7 billion surplus in 1973 to a \$2.3 billion deficit. A rapid increase in exports to developing countries during the first quarter was more than offset by import growth; higher prices boosted the value of oil imports to triple the level of last year, while non-oil imports continued to grow rapidly. Imports will continue to run well ahead of last year because of high

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prices, although non-oil imports are showing some signs of slackening. The value of exports, according to leading indicators, should continue to increase 35-40% through mid-year. Only a small increase in export volume has occurred thus far. Demand for many products will remain high, however, and Japanese manufacturers are increasingly seeking to expand exports to offset declines in domestic sales.

Government Policies

The government will probably continue its moderately restrictive monetary and fiscal policies at least until the July elections. Indeed, Finance Minister Fukuda has said that restraints will be continued until autumn to minimize the cost-push effect of the spring wage increases and rising oil prices. Continuing concern about inflation makes a relaxation of restrictive policies difficult until some progress is evident in controlling prices. Nevertheless, flagging demand for both investment goods and consumer durables will probably force some relaxation of government policies. If Tokyo waits until autumn, real GNP growth for the year will not exceed 3%. If it acts sooner, 5% growth can be attained, but at some cost in terms of inflation.

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JAPAN

	<u>1973</u>	<u>1st Qtr 1974 Preliminary</u>	<u>1st Half 1974 Estimated</u>	<u>2nd Half 1974 Estimated</u>	<u>1974 Estimated</u>
<u>Percentage Change at Annual Rate^{1/}</u>					
GNP Constant Prices	11.0	--	1.0	6.0	4.0
GNP Price Deflator	12.2	--	32.0	10.0	25.0
Consumer Prices	11.7	39.6			
Wholesale Prices	15.8	58.4			
Money Supply (m1)	16.8	--			
Money Supply (m2)	16.8	--			
<u>Billion US \$</u>					
Trade Balance	3.7	-1.8	-3.1	0.8	-2.3
Current Account Balance	-.1	-3.2	-5.9	-2.0	-7.9
Basic Balance	-9.8	-4.8	-8.5	-4.0	-12.5
Official Reserves ^{2/}	12.2	12.4			

^{1/} Change from previous period^{2/} End of period

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France

1974 Prospects

We expect French real GNP to grow 3.8% in 1974. Both domestic and foreign demand will remain strong and production of capital and intermediate goods is at near capacity levels. Output of consumer goods has dipped slightly since January, however, primarily because of declining automotive sales. Growth in the first half of the year will consequently slow to around 3.8% (at an annual rate). In the second half of the year, automotive sales should recover and real GNP growth should increase to about 4.6%. These projections are similar to those of the OECD.

The French GNP price deflator should increase around 10% this year, slightly less than predicted by the OECD. Consumer prices rose 18% during the first quarter while wholesale prices increased a phenomenal 71%. In both cases, higher oil prices were a major factor. The rate of inflation will decline through the remainder of 1974, but only because much of the effect of the oil price increase is now past. Consumer prices will continue to climb about 1% a month, bringing the total 1974 increase to about 13%.

We expect the French current account to show a \$4.3 billion deficit in 1974, almost \$1 billion more than expected by the OECD. The trade balance should shift from a \$1.6 billion surplus in 1973 to a \$3.3 billion deficit this year. A strong export surge held the first quarter trade deficit to about \$.7 billion, slightly less than anticipated. Nevertheless, the trade accounts should deteriorate through the remainder of the year, primarily as a result of higher oil import costs.

Government Policies

French policy continues to focus on inflation. Monetary policy remains tight and tax collections have been accelerated. Price controls have also been tightened and the government is exerting considerable pressure on

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business to hold down wage increases. To restrain domestic demand and free more goods for export, Paris wants little or no growth in real consumer purchasing power this year -- a difficult goal to attain. If the growth rate drops much below 4% in the second half, fiscal stimulation will probably follow -- most likely in the form of a cut in the value added tax.

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FRANCE

	<u>1973</u>	<u>1st Qtr 1974 Preliminary</u>	<u>1st Half 1974 Estimated</u>	<u>2nd Half 1974 Estimated</u>	<u>1974 Estimated</u>
<hr/> Percentage Change at Annual Rate ^{1/} <hr/>					
GNP Constant Prices	6.1	--	3.8	4.6	3.8
GNP Price Deflator	6.9	--	11.0	9.0	10.0
Consumer Prices	8.5	18.0			
Wholesale Prices	21.6	71.0			
Money Supply (m1)	10.6	-32.3			
Money Supply (m2)	14.9	-8.6			
<hr/> Billion US \$ <hr/>					
Trade Balance	1.6	-0.7	-1.5	-1.8	-3.3
Current Account Balance	-0.2	--	-2.0	-2.3	-4.3
Basic Balance	-2.3	--			
Official Reserves ^{2/}	8.5	8.1			

^{1/} Change from previous period^{2/} End of period

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West Germany1974 Prospects

We expect West German real GNP to increase 2.5% in 1974. Growth during the first half of the year will be impeded by lagging consumer demand resulting from last year's restrictive fiscal and monetary policies. In the second half, growth should accelerate as consumer demand picks up. The order backlog for capital goods rose in March for the first time since 1973. Some increase in demand is also reported for consumer non-durables and construction. This forecast is somewhat more optimistic than that of the OECD.

The GNP deflator will probably increase 7% this year, primarily as a result of higher fuel, material, and wage costs. Recent wage settlements have averaged around 14-15%. Consumer prices should increase around 10% in 1974. Although favorable by international standards, these rates are high for West Germany. OECD price forecasts are similar to our own.

We expect a \$2.5 billion surplus on West Germany's current account in 1974, or \$3.5 billion more than expected by the OECD. The trade balance will remain in massive surplus -- about \$9 billion -- despite soaring prices for imported raw materials, particularly oil. Strong foreign demand through most of the year and accelerating price rises will boost the value of exports. Net capital inflows may also resume because of Germany's relaxation of capital restrictions and the continuing strength of the mark, making it attractive to foreigners, including Arab investors.

Government Policies

Concern that the energy crisis would turn the government-induced 1973 economic slowdown into a full-fledged recession has forced the government to rescind most of its fiscal stabilization measures. Monetary policy, however, remains tight. At the present time, the government cannot decide on the relative priority to be afforded to employment as opposed to price stability. Brandt's Social Democrats stress policies promoting full employment, while the Free

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Democrats, as well as the opposition Christian Democrats, espouse fiscal measures aimed at further dampening demand to reduce inflation. The delicate balance that seems to exist between the two camps and continuing economic uncertainty will apparently result in the continuation of present policies through the remainder of 1974.

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WEST GERMANY

	<u>1973</u>	<u>1st Qtr 1974 Preliminary</u>	<u>1st Half 1974 Estimated</u>	<u>2nd Half 1974 Estimated</u>	<u>1974 Estimated</u>
Percent Change at Annual Rate ^{1/}					
GNP Constant Prices	5.3	--	2.6	4.6	2.5
GNP Price Deflator	6.1	--	9.8	8.4	7.0
Consumer Prices	6.9	7.2			
Wholesale Prices	6.7	12.8			
Money Supply (m1)	1.0	1.2			
Money Supply (m2)	14.4	--			
Billion US \$					
Trade Balance	16.0	5.5	5.5	3.5	9.0
Current Account Balance	3.5	--	1.5	1.0	2.5
Basic Balance	3.8	--	1.5	1.5	3.0
Official Reserves ^{2/}	33.1	32.0			

^{1/}Change from previous period^{2/}End of period

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ITALY

Italy's policies are being reassessed in light of the new import measures announced today. The estimates on the table should be viewed as tentative.

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ITALY

	<u>1973</u>	<u>1st Qtr.</u> <u>1974</u> <u>Preliminary</u>	<u>1st Half</u> <u>1974</u> <u>Estimated</u>	<u>2nd Half</u> <u>1974</u> <u>Estimated</u>	<u>1974</u> <u>Estimated</u>
	<u>Percentage Change at Annual Rate^{1/}</u>				
GNP Constant Prices 5.1		--	0.6	1.8	3.0
GNP Price Deflator 11.0		--	18.0	11.0	15.0
Consumer Prices 12.5		24.4			
Wholesale Prices 21.2 ^{b/}		--			
Money Supply (m1) 20.9		--			
Money Supply (m2) ---		--			

^{1/}Change from previous period

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United Kingdom

1974 Prospects

We expect British real GNP to decline 2% this year -- the first decline since 1952. As a result of the coal strike, weakening consumer demand and government measures to slow inflation, GNP will plummet 8% (at an annual rate) during the first half of the year, but then should recover sharply. Industrial output probably fell by at least 15% in the first quarter because of the 3-day workweek, and some firms have not yet resumed normal work schedules because of material shortages. OECD growth estimates are similar to our own while official estimates are somewhat optimistic, indicating no decline in real GNP.

The Wilson government probably will be unable to prevent the GNP deflator from rising about 11% this year, about the rate predicted by the OECD. Rising oil costs and wage increases intensified inflationary pressure in the first quarter. Consumer prices rose at an annual rate of 19.7%. The 30% pay raise recently granted to coal miners and substantial wage increases expected for other workers will generate continuing upward pressure on prices. Prices also will continue to be pushed up by higher oil costs.

We expect the British current account to show a record \$9 billion deficit this year, or \$1 billion more than expected by the OECD. The oil price hikes will add about \$5 billion to the import bill, resulting in a record \$11 billion trade deficit. Export demand has held up well because of sterling's depreciation, but export volume has stagnated because of production problems. These problems should ease by the third quarter. Stagnant export volume, along with the increased cost of imported oil, boosted the first quarter trade deficit to \$2.9 billion.

Government Policies

Economic policy has tightened somewhat under the Wilson government. In the new budget announced on 26 March, taxes were increased \$1.6 billion more than expenditures. If economic activity remains depressed and unemployment grows, however, the government may issue a somewhat expansionary

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mini-budget. Although the Bank of England has eased interest rates slightly in the past few weeks, they remain higher than elsewhere in Europe, and the monetary authorities are still trying to restrain the growth of monetary aggregates.

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UNITED KINGDOM

		1st Qtr 1974	1st Half 1974	2nd Half 1974	1974
	<u>1973</u>	<u>Preliminary</u>	<u>Estimated</u>	<u>Estimated</u>	<u>Estimated</u>
<u>Percentage Change at Annual Rate^{1/}</u>					
GNP Constant Prices	5.9	--	-8.0	9.0	-2.0
GNP Price Deflator	8.0	--	14.0	9.0	11.0
Consumer Prices	10.6	19.7			
Wholesale Prices	10.3	41.1			
Money Supply (m1)	4.1	-0.2			
Money Supply (m3)	28.9	17.0			
<u>Billion US \$</u>					
Trade Balance	-5.8	-2.9	-6.0	-5.0	-11.0
Current Account Balance	-3.6	-2.3	-5.0	-4.0	-9.0
Basic Balance	-3.2				
Official Reserves ^{2/}	6.5	6.4			

^{1/} Change from previous period^{2/} End of periodCIA/OER
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